ECONOMIC AND FINANCIAL OUTLOOK

Recession or Not, the Economy Will Bear the Consequences of the Trade War

By Jimmy Jean, Vice-President, Chief Economist and Strategist

One of the most pressing questions we get is whether a recession is on the horizon. It is also one of the hardest to answer with conviction. Just a few months ago, economists and financial markets broadly agreed that the Trump administration's trade policies—disruptive and fundamentally at odds with decades of liberalized trade—were steering the US economy towards contraction.

But Trump's tendency to delay, exempt or walk back his most aggressive proposals has muddied the picture. The risk of a prolonged tariff shock—particularly through the inflation channel and its erosion of household purchasing power—now appears somewhat reduced. The hard data so far, including on jobs and inflation, have shown limited damage. That offers a bit of reassurance, but it remains too early to conclude that the divergence between sentiment data, which many indicators have shown collapsing, and hard data, which shows resilience, will persist.

We expect the next quarters will see US domestic demand growth slow to a halt and inflation respond gradually to the rise in the effective tariff rate, higher inflation expectations and a weaker US dollar. An enduring rise in energy prices in the wake of the flare-up in Mideast tensions would further consolidate the trend. Recession risks are still elevated, but the US exited 2024 with strong momentum, and it might take more to push the economy over the edge.

Recession or not, it's the longer-term story that raises greater concern. The deeper damage stems from chronic uncertainty. When the rules keep shifting—on tariffs, immigration and taxation—it paralyzes decision making. If businesses expect another policy change just around the corner, whether positive or negative, they're less likely to commit. Hiring and investment get deferred. In a climate of permanent change, inertia becomes the default.

Add to that the growing perception that the United States is becoming a harder place to either export to or invest in. Measures like Section 899 introduced into the US tax code by the *One Big Beautiful Bill Act* being pushed through Congress targets foreign investors and businesses from countries with "discriminatory" tax policies, reflecting a broader shift towards using taxation as a tool of economic leverage. While tariffs are relatively unpopular and may face legal challenges, the instinct to use policy tools to pressure trading partners remains politically attractive to Republicans in Congress.

Meanwhile, escalating deportation rhetoric risks hollowing out the US labour force at a time when unemployment is already near historic lows and the population is aging. The attacks on the US's world-class academic and scientific institutions are equally troubling; these are not the kinds of wounds that show up in the next quarter's GDP, but the kind that reveal their damage across decades.

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In Canada, which has found itself on the receiving end of US hostility on multiple fronts, the economic damage is more visible. Trade volatility has surged, and early Q2 data confirm that net exports are weighing heavily on GDP. Employment in trade-sensitive sectors continues to soften, and there are early signs—albeit modest—of retaliatory tariff pass-through in inflation data.

Despite recent tax relief measures, the broader macro picture remains fragile. Slowing population growth, mortgage renewals at higher rates and faltering real estate markets in Toronto and Vancouver all point to further domestic headwinds. We expect real GDP to remain sluggish through the summer, with a recovery more likely in the fall. Unemployment, already rising in goods-producing sectors, is likely to spill over into services. From this perspective, recession risks appear more elevated in Canada than in the US, though it remains a close call. Rather than get lost in a semantic debate over the R word, it's more useful to view the next few months as a slump—one shaped by both global turbulence and made-in-Canada pressures, but with scope for a gradual rebound.

Central banks are walking a fine line. Both the Bank of Canada and the Federal Reserve remain vigilant, not because inflation is accelerating meaningfully just yet, but because inflation expectations are, and businesses appear to have every intention to pass cost increases along. Following the pandemic, many firms discovered they could raise prices, even when they didn't have to. This suggests a possible new pricing dynamic, one in which markups can be opportunistic, not just reactive, and central banks don't want to be caught downplaying this risk once again.

Still, that doesn't mean they have no more room left for rate cuts. Particularly in Canada, if domestic momentum weakens further, a widening output gap will exert additional downward pressure on inflation. Combined with tighter financial conditions—driven by a stronger loonie and elevated market yields—this implies that fiscal measures announced so far will come up short. While timely, tax relief measures are still relatively modest. Meanwhile, the fiscal pièce de résistance—namely, infrastructure projects—has yet to be detailed and will likely begin ramping up meaningfully only over the next several years.

Made-in-Canada Uncertainty

What sets this period apart is not just the economic conditions, but the policy environment itself. The 2025 federal election resulted in a Liberal minority government that has since pivoted to a more explicitly pro-growth agenda. Yet in the spirit of "not letting a good crisis go to waste," we've also witnessed the rushed passage of certain legislation, the postponement of the federal budget to fall 2025—creating uncertainty around fiscal direction—and a notable rhetorical shift on trade policy, from tit-for-tat assertiveness and shift towards Europe, to a more conciliatory tone with the US.

While these decisions may have sound strategic underpinnings, they contribute to a broader sense of unpredictability about the government's overarching vision, particularly given how significantly it diverges from the approach of the same party under its previous leadership. The good news is that there are strong signals that Canada is now more open for business. The bad news is that if it seems too good to be true, it probably is. Sooner or later, the government's bold ambitions will run up against familiar obstacles: labour shortages, union resistance, political friction and jurisdictional constraints. The real test will be how it manages to navigate these headwinds in a minority context.

The bottom line is that the economy is likely to limp rather than leap forward in the near term—and that's before accounting for the litany of risks explored in this report. Policy coherence will remain elusive, the waters will stay murky and predictability, which is the cornerstone of effective decision making, will be in short supply. We still expect cooler heads to prevail and clearer skies to emerge, but for now, that outlook rests uncomfortably more on hope that political incentives will align to produce such an outcome than on any firm signal.

RISKS INHERENT IN OUR SCENARIOS

The first few months of Donald Trump's second term have triggered a massive spike in uncertainty all over the world. That uncertainty has been amplified by the tariffs that have been announced (and in some cases, rolled back or delayed), additional threats from the US and the scope of the retaliatory measures imposed by other countries. Furthermore, the other policies implemented by the US administration, especially regarding immigration and the federal government apparatus, could create labour shortages in key sectors and exert pressure on employment dynamics. Assuming the full passage of the *One Big Beautiful Bill Act* through Congress, we'll need to watch how the bond markets respond to the increased US Treasury supply, especially if the deficit grows materially. US bonds and other assets may also be shunned, as disruptive policies may lead global investors to reduce their portfolio exposure to the US. There's a lot of uncertainty over how much room central banks have to cut interest rates in a situation where growth slows but inflation doesn't. Renewed tensions in the Middle East may further delay cuts if the geopolitical risk premium sends energy prices soaring. We'll also need to keep an eye on whether the Federal Reserve (Fed) manages to maintain its independence. Long-term political fragmentation and fiscal pressures could undermine governments' ability to respond to economic downturns while keeping public finances on sound footing and avoiding downgrades to their credit ratings. Add to this the risks of financial instability, including those that can arise when regulatory environments are laxer. Stock markets, bond markets, currency fluctuations and commodity prices could become more volatile, further slowing the global economy.

Table 1
Global GDP Growth (Adjusted for PPP) and Inflation Rates

%	Weight*	Real GDP growth 2024	Real GDP growth 2025f	Real GDP growth 2026f	Inflation rate 2024	Inflation rate 2025f	Inflation rate 2026f
Advanced economies	**37.7**	**1.6**	**1.1**	**1.0**	**2.6**	**2.4**	**2.2**
United States	14.8	2.8	1.4	1.4	3.0	2.8	2.6
Canada	1.3	1.6	1.4	1.4	2.4	2.2	2.1
Quebec	*0.3*	*1.4*	*1.1*	*1.2*	*2.3*	*2.2*	*2.1*
Japan	3.4	0.2	0.7	0.4	2.7	2.8	1.6
United Kingdom	2.2	1.1	1.0	0.7	2.5	3.0	2.4
Eurozone	11.9	0.8	1.1	0.7	2.4	2.0	1.9
Germany	*3.2*	*-0.2*	*0.2*	*0.3*	*2.3*	*2.1*	*2.1*
France	*2.3*	*1.1*	*0.4*	*0.5*	*2.0*	*1.2*	*1.7*
Italy	*1.9*	*0.5*	*0.7*	*0.5*	*1.0*	*1.8*	*1.8*
Other countries	4.1	1.5	1.0	1.5	2.5	1.9	2.0
Australia	*1.0*	*1.0*	*1.3*	*1.8*	*3.2*	*2.5*	*2.8*
Emerging and developing economies	**62.3**	**3.9**	**3.4**	**3.5**	**7.3**	**4.6**	**3.9**
Emerging Asia	32.8	5.2	4.5	4.3	2.0	1.5	2.1
China	*18.8*	*5.0*	*4.3*	*3.7*	*0.2*	*0.3*	*0.9*
India	*7.9*	*6.5*	*6.1*	*6.2*	*5.0*	*4.0*	*4.6*
Latin America	5.8	2.3	1.4	1.6	4.2	4.4	3.9
Mexico	*1.8*	*1.4*	*-0.1*	*1.1*	*4.7*	*3.8*	*3.7*
Brazil	*2.4*	*3.0*	*1.8*	*1.5*	*4.0*	*5.4*	*4.4*
Eastern Europe	8.5	3.7	2.0	2.5	19.5	13.2	9.2
Russia	*3.5*	*4.3*	*1.2*	*1.2*	*8.4*	*7.1*	*5.2*
Other countries	15.2	1.9	2.2	2.8	16.4	8.9	7.5
South Africa	*0.5*	*0.4*	*0.9*	*1.5*	*4.4*	*3.6*	*4.3*
World	**100.0**	**3.1**	**2.5**	**2.6**	**5.5**	**3.8**	**3.3**

f: forecast; PPP: Purchasing Power Parities, exchange rates that equate the cost of a broad basket of goods and services across countries; * 2023.
World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECASTS

Positive developments on trade and the potential for more infrastructure and defence spending are supporting the Canadian economic outlook, but there is still scope for more monetary easing. Economic activity is currently weak, unemployment is high, and slowing population growth and ongoing mortgage renewals remain headwinds. While further progress on core inflation is necessary, we continue to forecast that the Bank of Canada will cut rates by an additional 75bps in 2025. Look for the yield curve to steepen, with longer-term interest rates supported by global factors. The de-escalation of trade tensions between the US and China has boosted risk sentiment and reduced the odds of a global recession. As a result, we have revised our year-end equity forecasts higher. The de-escalation has also lowered our outlook for US inflation, so we still expect the Fed to cut rates three times this year. Investors are increasingly interested in rotating away from US assets, which could benefit Canadian equities. We therefore expect the TSX to continue outperforming the S&P 500. Conflicts in the Middle East are creating market volatility. While the recent correlation between oil prices and CAD has been low, correlations tend to rise during geopolitical shocks. We remain bearish on the US dollar in the medium term.

Table 2
Summary of Financial Forecasts

End of period in %	2024		2025				2026			
(unless otherwise indicated)	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key interest rate										
United States	5.00	4.50	4.50	4.50	4.25	3.75	3.75	3.50	3.25	3.25
Canada	4.25	3.25	2.75	2.75	2.25	2.00	2.00	2.00	2.00	2.25
Eurozone	3.50	3.00	2.75	2.50	2.00	1.75	1.75	1.75	1.75	2.00
United Kingdom	5.00	4.75	4.50	4.25	4.00	4.00	4.00	3.50	3.75	4.00
Federal bonds										
United States										
2-year	3.68	4.24	3.94	3.80	3.65	3.55	3.50	3.45	3.35	3.35
5-year	3.56	4.38	3.95	3.90	3.80	3.75	3.70	3.65	3.55	3.60
10-year	3.78	4.57	4.21	4.35	4.25	4.15	4.10	4.10	4.00	4.00
30-year	4.13	4.79	4.59	4.80	4.70	4.65	4.55	4.50	4.35	4.35
Canada										
2-year	2.91	2.93	2.46	2.50	2.25	2.10	2.00	2.10	2.25	2.40
5-year	2.73	2.96	2.61	2.75	2.50	2.40	2.40	2.45	2.50	2.55
10-year	2.95	3.23	2.97	3.15	3.05	2.95	2.80	2.75	2.75	2.80
30-year	3.13	3.33	3.23	3.45	3.35	3.25	3.10	3.05	3.05	3.10
Currency market										
Canadian dollar (USD/CAD)	1.35	1.44	1.43	1.38	1.36	1.35	1.35	1.34	1.32	1.30
Canadian dollar (CAD/USD)	0.74	0.70	0.70	0.72	0.74	0.74	0.74	0.75	0.76	0.77
Euro (EUR/USD)	1.12	1.04	1.09	1.15	1.17	1.20	1.20	1.20	1.18	1.15
British pound (GBP/USD)	1.34	1.25	1.30	1.34	1.35	1.36	1.36	1.36	1.35	1.35
Yen (USD/JPY)	143	157	148	140	138	135	135	135	130	130
Stock markets (level and growth)*										
United States – S&P 500	5,882 (23.3%)		Target: 6,100 (+3.7%)				Target: 7,000 (+14.8%)			
Canada – S&P/TSX	24,728 (18.0%)		Target: 26,600 (+7.6%)				Target: 29,500 (+10.9%)			
Commodities (annual average)										
WTI oil (US$/barrel)	77 (70*)		68 (65*)				65 (65*)			
Gold (US$/ounce)	2,390 (2,625*)		3,210 (3,350*)				3,255 (3,185*)			

f: forecast; WTI: West Texas Intermediate; * End of year.
Datastream and Desjardins Economic Studies

Overseas

The Global Economy Cannot Ignore US Protectionism

FORECASTS

The global economy is sending mixed signals. First-quarter growth was fairly solid in several European countries, partly due to a front-loading of activity ahead of potential US tariffs. The start of the year was gloomier elsewhere, including in Japan, South Korea and the United States. US trade policy—and particularly tension between Washington and Beijing—likely exerted a drag in the second quarter, and growth in subsequent quarters will probably be rather muted. Global real GDP is expected to rise by 2.5% in 2025 and 2.6% in 2026.

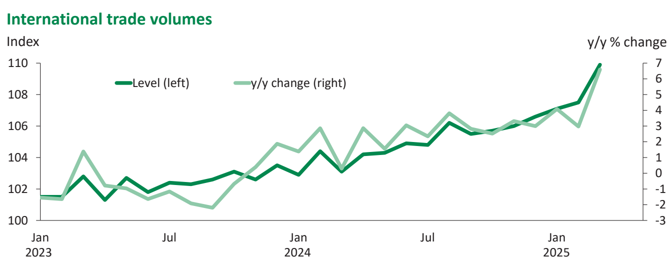
Key economic indicators have been hot and cold since early 2025. Initial signs of economic strength early in the year have faded, and the current headwinds are now largely attributed to President Trump's protectionist agenda. We project that trade policy will remain essentially unchanged for the rest of the year. US tariffs on imports from China are expected to remain at 30%, while those on Mexico and Canada are likely to stay at 25% with the existing exemptions. For other countries, we expect tariffs to remain at 10%, and we don't assume a return to variable reciprocal tariffs. That being said, the situation is still fluid, and our economic and financial scenarios will be updated as trade policies evolve.

Ironically, the Trump administration's initial introduction of tariffs and fears of increased US trade barriers boosted exports from a number of countries in the first quarter of 2025. Global trade volume was 6.6% higher than a year earlier (graph 1). However, we know that US imports fell in April and exports from several countries declined in April or May. This pullback could last a few months, but we don't expect it to cause a severe downturn in economic activity.

The situation could have been much worse had the protectionist escalation between the United States and China not subsided. May's agreement and June's framework for a trade deal between the two countries, which account for about a third of the global economy, will help avoid recessions in both. They also mitigate any collateral damage that could have rocked the global economy, particularly due to supply chain disruption. We still expect trade between the two countries to fall and, given the lingering uncertainty, China's economy is likely to slow in the coming quarters. China's annualized real GDP growth in 2025 will still benefit from the pull-forward in activity at the start of the year, which helped boost exports and industrial production.

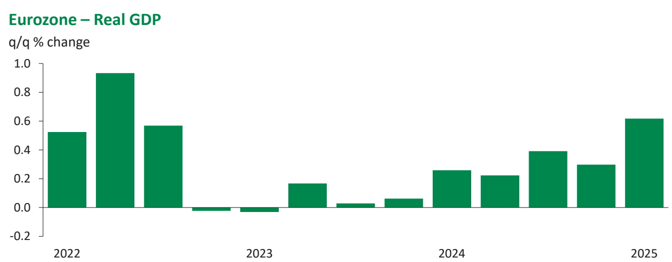
In Europe, the data are rather mixed. The main indicators published recently have generally exceeded expectations, albeit rather low ones. Eurozone real GDP grew a non-annualized 0.6% in the first quarter of 2025, its best performance since the second quarter of 2022 (graph 2). The unemployment rate remains relatively low, and inflation has returned to the European Central Bank's target, giving it room to continue cutting its key rates. However, we don't expect the eurozone economy to grow strongly in the coming quarters. The pullback in US imports and acute uncertainty will also impact the region, especially since the euro's appreciation is acting as a headwind for exporters (graph 3). Germany, which relies heavily on its manufacturing sector, could be more affected than other countries in the region. In the medium term, especially starting in 2027, we can expect greater momentum in German and European growth driven by increased military spending.

Graph 1
International Trade Surged Early in the Year



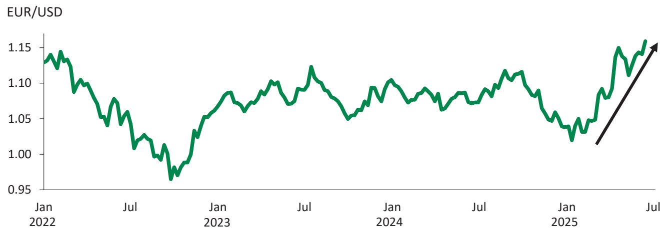
CPB Netherlands Bureau for Economic Policy Analysis and Desjardins Economic Studies

Graph 2
The Eurozone Economy Started 2025 on a Positive Note



Eurostat and Desjardins Economic Studies

Graph 3
The Euro Has Appreciated in Recent Months



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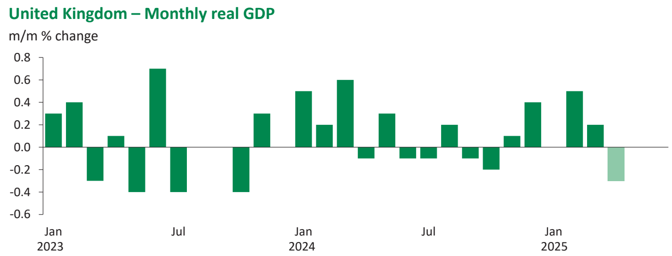
Graph 4
The UK Economy Made a Poor Start to the Second Quarter



Office for National Statistics and Desjardins Economic Studies

The United Kingdom saw non-annualized real GDP growth of 0.7% in the first quarter. However, recent data has been less positive, with monthly real GDP falling 0.3% in April, its worst print since October 2023 (graph 4). We're also seeing a slowdown in the labour market. UK real GDP is likely to come in flat in the second quarter, followed by weak growth for the rest of the year.

Japan's real GDP growth was zero in the first quarter of 2025. This weakness was mainly due to a decline in government spending and, surprisingly, a drop in exports. US tariffs and uncertainty are also likely to hamper economic activity in the coming quarters.

The weak global economy will limit demand for oil in the coming months. What's more, supply growth is expected to maintain the market glut as OPEC+ continues to ramp up production in an effort to regain the market share lost since the pandemic. The recent escalation of the conflict between Israel and Iran could constrain the upside potential for global oil production. While it is still too early to assess the full extent of the damage to Iran's oil industry, a decline in output appears likely. Against this backdrop, we've updated our year-end target for WTI (West Texas Intermediate) to US$65 per barrel.

United States

Economic Growth Is Being Hampered by Tariffs and Uncertainty

FORECASTS

The US economy is resilient, but some weak points have emerged. It's clear that the current trade policy is having an impact, and the uncertainty generated by the tariff announcements will continue to weigh on growth in the quarters ahead. As a result, real GDP growth is expected to remain modest through the spring and summer. From the fall and into early 2026, new fiscal and budgetary measures should give growth a bit of a boost. All the same, unemployment is projected to rise, and tariffs will likely drive inflation up.

The economic landscape in the United States has shifted. In the years following the pandemic and through the end of 2024, the US was among the top-performing economies, with notable gains in productivity. That changed in the first quarter of 2025, when real GDP contracted by 0.2%.

This weakness largely stems from businesses frontloading imports in anticipation of the Trump administration's announced tariffs. While final domestic demand grew at an annualized rate of just 2.0%, imports surged by 42.6%—the highest quarterly increase since 1972, excluding the pandemic period.

Given the erratic nature of White House tariff announcements (graph 5), as well as the chance of retaliatory measures from other countries, we can assume that international trade will introduce significant volatility into GDP. After their first-quarter spike, imports began noticeably falling in the second quarter, which should contribute positively to real GDP growth. That being said, we can expect domestic demand to falter as well, weighed down by sustained uncertainty and wavering confidence (graph 6).

Easing trade tensions between the US and China should help both economies avoid a worst-case scenario. Trade flows appear to be recovering: after a steep decline, transpacific container bookings are on the rise again, and maritime shipping costs have surged in recent weeks.

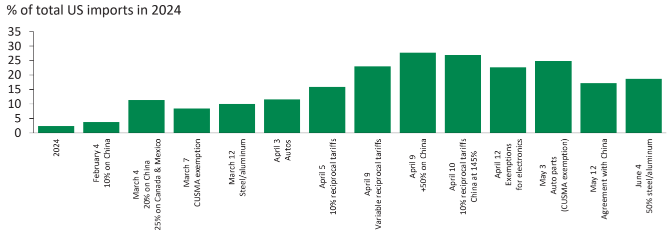
But the protectionist trade policies adopted by the United States will leave some lasting damage. Tariffs remain significantly higher than at the start of the year, and a slower pace of global trade is expected in the coming years, which will drag on economic vitality. The uncertainty stemming from White House policies remains extremely high. Inflation expectations among households and businesses have risen, and confidence has dropped sharply, though the temporary truce with China has brought some stabilization. There's also the chance that more tariffs will be announced. These conditions will weigh on consumption and investment in the quarters ahead—on top of the pullback expected in the wake of the tariff front-running we saw in the first quarter.

The worst outcomes from these tariffs have not yet materialized, though. Inflation remains moderate, though the year-over-year change in core CPI is still above the Federal Reserve target. Goods prices are expected to gradually accelerate starting this summer. The labour market remains relatively strong, with 619,000 jobs created since the beginning of the year. It's

Graph 5
US Tariffs Have Changed Repeatedly and Remain Relatively High

US effective tariff

% of total US imports in 2024

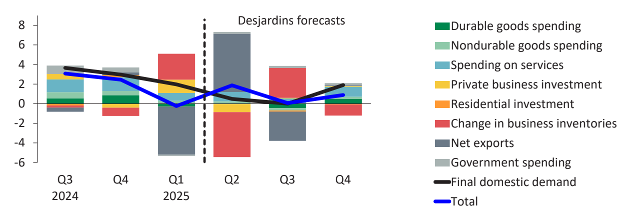


U.S. International Trade Commission, White House and Desjardins Economic Studies

Graph 6
Domestic Demand Growth Is Expected to Weaken

United States – Contributions to annualized quarterly real GDP growth

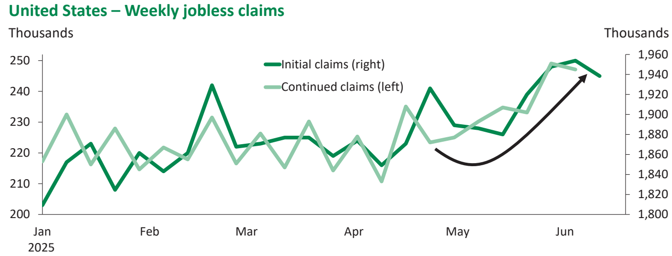
%



Bureau of Economic Analysis and Desjardins Economic Studies less dynamic than it was a year ago, though, and weekly jobless claims have recently trended upward (graph 7). Federal budget cuts are also expected to impact net hires more significantly, especially this fall. In the meantime, the Trump administration's anti-immigration stance will exert downward pressure on labour force growth, limiting the rise in unemployment.

While it hasn't been set in stone, and the White House still needs to win over Republicans in the House and Senate, we still have a fairly good idea of what the budget will look like. As predicted, the 2017 tax cuts will be extended. We can also expect some of the other cuts that Trump promised on the campaign trail. We can expect the *One Big Beautiful Bill Act* to have some positive effects on household disposable income and investment in equipment starting this fall and carrying over through early 2026. It remains to be seen whether further deterioration in federal public finances will unsettle investors, which could put additional upward pressure on bond yields.

Graph 7
Is This the Start of Bad News for the Job Market?



U.S. Department of Labor and Desjardins Economic Studies

Table 3
United States: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2024 Q3	2024 Q4	2025 Q1	2025 Q2f	2025 Q3f	2025 Q4f	Annual average 2023	2024	2025f	2026f
Real GDP (2017 US$)	**3.1**	**2.5**	**-0.2**	**1.8**	**0.1**	**0.9**	**2.9**	**2.8**	**1.4**	**1.4**
Personal consumption expenditures	3.7	4.0	1.2	1.7	-0.2	2.6	2.5	2.8	2.1	1.6
Residential construction	-4.3	5.5	-0.6	-1.1	-2.8	-1.4	-8.3	4.2	-0.5	-1.2
Business fixed investment	4.0	-2.9	10.3	-6.0	0.5	0.5	6.0	3.6	1.6	0.7
Inventory change (2017 US$B)	57.9	8.9	163.0	-100.0	75.0	10.0	33.1	39.0	37.0	26.3
Public expenditures	5.1	3.1	-0.7	1.0	1.2	1.2	3.9	3.4	1.6	1.4
Exports	9.6	-0.2	2.4	-2.3	-6.7	0.9	2.8	3.3	0.5	0.7
Imports	10.7	-1.9	42.6	-46.5	17.5	0.0	-1.2	5.3	0.7	-0.9
Final domestic demand	3.7	3.0	2.0	0.5	0.0	1.9	2.7	3.0	1.9	1.4
Other indicators										
Nominal GDP	5.0	4.8	3.4	4.5	2.6	4.3	6.6	5.3	4.2	4.0
Real disposable personal income	0.2	2.5	2.9	5.4	-0.5	3.6	5.1	2.7	2.4	2.7
Employment[1]	0.9	1.3	1.3	1.0	0.2	-0.7	2.2	1.3	0.9	0.1
Unemployment rate (%)	4.2	4.1	4.1	4.2	4.5	4.7	3.6	4.0	4.4	4.9
Housing starts[2] (thousands of units)	1,338	1,387	1,401	1,333	1,330	1,317	1,421	1,371	1,345	1,294
Corporate profits*[3]	6.0	6.9	5.5	1.0	0.5	-3.8	6.9	7.9	0.7	3.6
Personal savings rate (%)	4.1	3.8	4.3	5.3	5.1	5.4	3.4	4.6	5.0	6.0
Total inflation rate*	2.7	2.7	2.7	2.4	2.9	3.1	4.1	3.0	2.8	2.6
Core inflation rate*[4]	3.3	3.3	3.1	2.8	3.3	3.5	4.8	3.4	3.2	2.9
Current account balance (US$B)	-1,241	-1,216	-1,593	-937	-1,153	-1,147	-905	-1,134	-1,208	-1,147

f: forecast; * Annual change; [1] According to the establishment survey; [2] Annualized basis; [3] Before taxes; [4] Excluding food and energy.
Datastream and Desjardins Economic Studies

Canada

2025: We're Halfway There and Canada's Living on a Prayer

FORECASTS

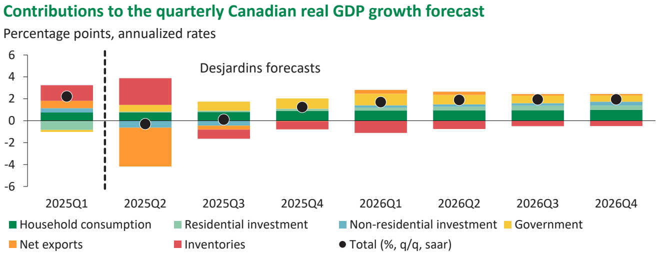
2025 is nearing the halfway mark, and Canada continues to grapple with unprecedented uncertainty. Tariffs and the Trump trade war have strained its long-standing economic relationship with the United States. Without a new trade agreement, we remain at a fragile standstill. On top of this, Canadians elected a new government after months of political limbo. The newly elected prime minister promises ambitious infrastructure and defence investments, but whether these materialize remains to be seen. Meanwhile, inflation and affordability remain top concerns for Canadians. While scrapping the price on pollution and cutting personal income taxes may offer some relief, retaliatory tariffs are expected to exert pressure on households' purchasing power in the months ahead.

Tariffs have dominated Canada's real GDP outlook since the start of the year (graph 8). Oscillating rounds of on-again, off-again levies have resulted in higher trade costs and uncertainty for what the future holds. April marked the largest trade deficit on record. We anticipate net exports to drag down growth in the near term due to deteriorating trade ties with the US. Business investment is expected to decline amid lower external demand and rising uncertainty and costs from retaliatory tariffs. Residential investment will likely remain weak as economic and labour market concerns dampen demand. Still, it's not all bleak—despite the mortgage renewal wall hitting households in 2025 and 2026, consumption should hold up, supported by stable durable goods spending. Additionally, federal fiscal measures like the Canada Day income tax cut and reversal of the capital gains inclusion rate hike should add an extra boost to household consumption.

Given the likely economic drag from tariffs, the newly elected federal government has laid out an ambitious infrastructure and defence investment plan to jump-start the Canadian economy. However, following through with this promise comes with a hefty price tag—large budget deficits and substantial debt accumulation. As a result, Canada's debt-to-GDP ratio is sure to rise, and its fiscal credibility could be compromised. (See our analysis of this potential risk.) Still, the benefits could be substantial. As mentioned in our recent research, the federal plan to deliver $25B in non-residential, non-defence infrastructure investment over four years could increase the level of real GDP by 0.6% (graph 9). Regardless, there is reason for skepticism given the government's lacklustre record of delivering on infrastructure commitments in the past. The same could be said of the recent announcement that Canada will meet its 2% of GDP NATO defence spending target in the 2025–26 fiscal year and likely increase it thereafter.

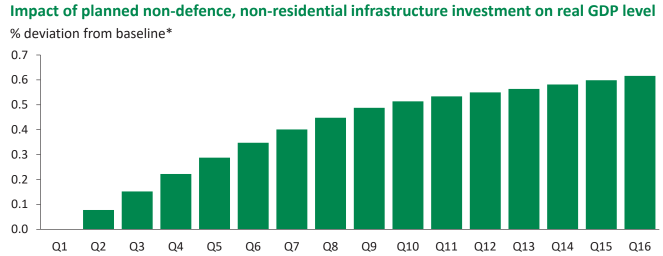
Although tariffs dominate the headlines, inflation and affordability remain key concerns for many Canadians. In March 2025, the federal government announced the removal of the price on pollution to provide relief for Canadians in provinces covered by the federal carbon price system that were struggling

Graph 8
Trade is Dragging Down Growth As Canada Is Hit Hard With Tariffs



Statistics Canada and Desjardins Economic Studies

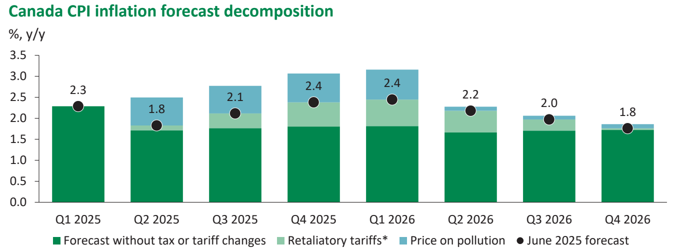
Graph 9
Planned Infrastructure Investment Could Boost Real GDP



* Based on Desjardins Economic Studies May 2025 Economic and Financial Outlook.
Liberal Party of Canada and Desjardins Economic Studies

with inflation. Our estimates suggest that CPI inflation was roughly 0.7% lower in April 2025 than it would have been if the emissions price were maintained. The April inflation data showed dramatically slower price growth as a result of the removal of the federal price on pollution. However, the continued reacceleration of core inflation is worrying, partly reflecting the reciprocal tariffs on imports from the US. Indeed, our research suggests CPI inflation will be roughly 0.6% higher over the year starting in April as a result of Canada's retaliatory tariffs (graph 10).

Graph 10
Retaliatory Tariffs Are a Major Source of Inflationary Pressures



*Up to and including tariffs announced as of June 6, 2025.
Government of Canada, Statistics Canada and Desjardins Economic Studies

Table 4
Canada: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2024 Q3	2024 Q4	2025 Q1	2025 Q2f	2025 Q3f	2025 Q4f	Annual average 2023	2024	2025f	2026f
Real GDP (2017 $)	**2.4**	**2.1**	**2.2**	**-0.3**	**0.1**	**1.2**	**1.5**	**1.6**	**1.4**	**1.4**
Final consumption expenditure [of which:]	4.7	4.1	0.8	1.6	1.9	2.1	2.0	2.7	2.4	2.0
Household consumption expenditure	*4.4*	*4.9*	*1.2*	*1.4*	*1.5*	*1.7*	*1.8*	*2.4*	*2.4*	*1.7*
Government consumption expenditure	*5.5*	*2.4*	*-0.3*	*2.3*	*3.2*	*3.2*	*2.2*	*3.7*	*2.4*	*3.0*
Gross fixed capital formation [of which:]	-1.8	9.0	-3.0	-1.8	-0.8	1.9	-1.6	0.1	0.5	2.2
Residential structures	*5.4*	*16.8*	*-10.9*	*1.0*	*1.5*	*2.5*	*-8.5*	*-0.6*	*0.6*	*3.4*
Non-residential structures	*-0.8*	*1.4*	*-6.1*	*-4.3*	*-3.6*	*-0.5*	*3.2*	*-2.1*	*-2.1*	*0.6*
Machinery and equipment	*-27.7*	*10.5*	*22.9*	*-13.5*	*-9.2*	*-0.2*	*-2.7*	*-2.9*	*0.4*	*-1.1*
Intellectual property products	*6.4*	*4.1*	*-1.5*	*1.2*	*1.5*	*1.7*	*4.0*	*0.0*	*1.7*	*1.7*
Government gross fixed capital formation	*4.0*	*7.3*	*-3.2*	*3.2*	*4.0*	*6.4*	*4.8*	*7.3*	*2.9*	*5.8*
Investment in inventories (2017 $B)	20.0	-6.0	2.7	15.3	11.0	7.2	25.5	14.3	9.1	-3.4
Exports	-0.6	7.1	6.7	-20.6	-0.3	1.5	5.0	0.6	-1.7	1.0
Imports	-1.0	2.5	4.4	-9.7	0.8	1.6	0.3	0.7	-0.3	1.5
Final domestic demand	3.2	5.2	-0.1	0.8	1.3	2.0	1.1	2.1	2.0	2.1
Other indicators										
Nominal GDP	5.0	5.8	4.9	-2.0	-3.4	5.3	2.9	4.7	2.8	1.8
Real disposable personal income	9.7	-0.2	0.4	2.6	3.3	0.0	1.6	4.6	2.6	0.9
Employment	0.8	1.9	2.7	0.0	-0.2	-0.2	3.0	1.9	1.2	0.2
Unemployment rate (%)	6.5	6.7	6.6	7.0	7.3	7.4	5.4	6.4	7.1	7.2
Housing starts[1] (thousands of units)	238	248	223	268	240	235	242	245	242	234
Corporate profits*[2]	-4.6	-3.0	8.5	1.2	2.2	0.0	-14.8	-3.1	2.9	7.3
Personal savings rate (%)	7.2	6.0	5.7	6.0	6.4	6.0	3.7	6.0	6.0	5.2
Total inflation rate*	2.0	1.9	2.3	1.8	2.1	2.4	3.9	2.4	2.2	2.1
Core inflation rate*[3]	2.5	2.1	2.5	2.5	2.7	3.0	3.9	2.6	2.7	2.4
Current account balance ($B)	-2.9	-3.6	-2.1	-7.1	-4.2	-3.3	-18.4	-14.1	-16.7	-10.0

f: forecast; * Annual change; [1] Annualized basis; [2] Before taxes; [3] Excluding food and energy.
Datastream and Desjardins Economic Studies

Quebec

The Economic Slowdown Has Arrived … in Slower than Expected Motion

FORECASTS

Quebec entered its current period of turbulence on solid footing, closing out 2024 with annualized real GDP gains of 1.8% and 1.4% in the last two quarters of the year. Recent data suggest that growth picked up slightly in Q1 2025, driven by an increase in exports as companies frontloaded their deliveries ahead of the tariffs initially announced for April. The labour market remained stronger than expected. While the province will most likely see a slowdown in the quarters ahead, public investments should help stave off the worst of the damage. In the medium term, growth will be undercut by demographic pressures and efforts to balance the budget, especially at the provincial level.

After a strong start to 2024, with annualized growth near 3% in the first two quarters, Quebec's economy began to slow. It continued to grow at a slightly slower pace than the rest of Canada, although performance remained solid overall. Given the industries targeted by US tariffs (the ones in place, the ones partly implemented and the ones that have simply been announced), Quebec should feel the impacts more acutely than the country as a whole. This increased pressure means the province will struggle in 2025.

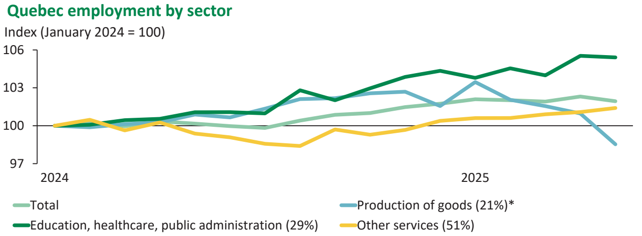
For now, economic indicators have been more favourable than anticipated, prompting an upward revision of our forecasts. Quebec's real estate market remains robust. Existing home sales and housing starts are both holding above the national averages, and mortgage renewals are taking a comparatively smaller bite from household budgets. The labour market is also proving to be more resilient than expected. However, the employment gains recorded since the beginning of the year suggest that this momentum may soon wane. Gains were largely concentrated in sectors closely linked to public spending, such as education, healthcare and public administration (graph 11). Quebec's manufacturing sector has been shedding jobs since January, when the new US president took office and tariff threats began escalating.

Inflation should also remain slightly higher in Quebec, as it's the only province that hasn't abandoned its consumer-side carbon pricing scheme. The retaliatory tariffs will also push inflation higher, though the economic slowdown should help keep it in check. We expect inflation to stay just above 2% for the rest of the year.

Quebec's real GDP should fare better in the last quarter of the year, partly supported by public investment. The federal government has made several announcements that should spur growth, including its pledge to meet NATO's 2% defence spending target. Provincial contributions will play a pivotal role as well, with Hydro-Québec ramping up investments and the most recent budget earmarking an additional $11 billion over the next three years for the Quebec Infrastructure Plan (graph 12). The decision to pull this public spending forward should generate positive spinoffs for several manufacturing sectors, particularly those weakened by the current geopolitical dynamic.

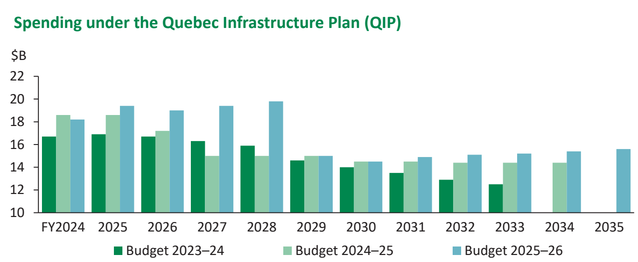
In the medium term, easing trade tensions should help Quebec bounce back to a pace just above the national average. But this performance will ultimately be undermined by structural issues, with demographics being the main detractor. Natural population growth turned negative for the first time last year, with more

Graph 11
Public Spending Is a Key Factor in Labour Market Strength



* Average share of jobs in these sectors of Quebec's economy in 2024.
Note: The percentages in the legend add up to 101% due to rounding.
Statistics Canada and Desjardins Economic Studies

Graph 12
Infrastructure Spending Has Been Fast-Tracked

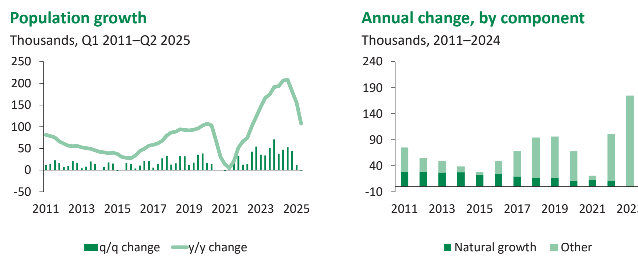


FY: Fiscal year
Ministère des Finances du Québec and Desjardins Economic Studies

deaths recorded than births (graph 13). Under the immigration targets being considered, our forecasts suggest that the working-age population in Quebec will flatline at best. This could limit economic activity in regions already grappling with labour shortages.

Another factor that may weigh on economic growth in the medium term is provincial government spending. The most recent budget calls for annual expenditure growth that barely keeps pace with inflation and ultimately amounts to nearly zero growth in real terms. If these projections hold, the planned spending path would mark the weakest contribution to growth in the past two decades.

Graph 13
Population Growth Is Continuing to Slow



Statistics Canada and Desjardins Economic Studies

Table 5
Quebec: Major Economic Indicators

Annual average % change (unless otherwise indicated)	2022	2023	2024	2025f	2026f
Real GDP (2017 $)	**3.4**	**0.6**	**1.4**	**1.1**	**1.2**
Final consumption expenditure [of which:]	4.6	0.7	3.0	2.6	0.7
Household consumption expenditure	*5.5*	*1.8*	*3.1*	*2.8*	*1.0*
Government consumption expenditure	*2.4*	*-1.7*	*3.2*	*2.1*	*-0.1*
Gross fixed capital formation [of which:]	-2.3	-3.7	-0.3	2.5	2.5
Residential structures	*-11.1*	*-15.1*	*2.9*	*8.8*	*3.9*
Non-residential structures	*3.7*	*5.9*	*-0.7*	*-5.7*	*0.4*
Machinery and equipment	*11.6*	*-6.3*	*-2.0*	*0.3*	*-1.1*
Intellectual property products	*6.3*	*4.2*	*0.2*	*2.3*	*2.0*
Government gross fixed capital formation	*-2.4*	*7.2*	*-2.8*	*1.0*	*3.9*
Investment in inventories (2017 $B)	11	6	3	-1	0
Exports	2.0	4.0	0.9	-0.5	2.8
Imports	6.9	-0.8	2.0	0.9	2.1
Final domestic demand	3.0	-0.2	2.4	2.7	1.1
Other indicators					
Nominal GDP	8.7	5.0	5.6	3.0	2.9
Real disposable personal income	1.1	0.1	4.4	3.8	2.0
Weekly earnings	4.1	3.6	4.5	4.2	3.1
Employment	3.1	2.9	0.9	1.3	0.1
Unemployment rate (%)	4.3	4.4	5.3	6.1	6.0
Personal savings rate (%)	9.3	7.8	9.1	8.9	9.3
Retail sales	8.5	3.7	2.1	3.5	4.5
Housing starts[1] (thousands of units)	57.1	38.9	48.7	57.3	57.4
Total inflation rate	6.7	4.5	2.3	2.2	2.1

f: forecast; [1] Annualized basis.
Statistics Canada, Institut de la statistique du Québec, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

Medium-Term Issues and Forecasts

Are There Risks of Overheating in the Medium Term?

Even as concerns over the Trump administration's economic policies persist, the medium-term forecast offers us some room for cautious optimism. International trade will likely bear lasting scars, which could in itself keep economic growth below potential for quite some time. But other factors could tip the scale toward sustained economic growth in many countries over the medium term, such as increased investment and military spending. That said, economic growth will be limited by access to resources, labour and capital. And pushing the economy too far could lead to overheating.

Can We Hope for a Midterm Reset?

US presidents serve four-year terms, but their ability to actually get things done relies heavily on their political alignment with the House of Representatives and Senate. The midterm elections will be held on November 3, 2026, and any shift in the balance of congressional power could rein in Trump's influence. If Americans have seen no improvement in their standard of living—especially the working class—Democrats could win back a number of seats, most likely in the Senate. Businesses hurt by tariffs and other policies may be more inclined to donate to the Democratic Party. And Trump had a falling out with Elon Musk, a key ally during his last campaign. That said, election outcomes are notoriously hard to predict.

Whatever happens during the midterms, we believe that international trade will still be impacted by US protectionist trade policy. Many countries will need to keep adapting to this new reality, and Canada is no exception. Exporters will need to diversify their market base and cultivate new trade partnerships. Supply chains will adjust and new opportunities will arise. Canada has already signed several free trade agreements and has the potential to expand its trade with other countries over the medium and long term.

Domestic Demand May Also Fuel Growth

Medium-term economic growth could be driven primarily by domestic demand, with many countries looking inward. Canada in particular has a list of spending and investment projects planned. At the top of the list, we still expect residential construction to accelerate gradually and alleviate the housing crisis. There are also major infrastructure needs across the country. And businesses may ramp up their investments in artificial intelligence and other areas to boost productivity.

Military spending has also increased and warrants mention in our forecasts. Global geopolitical uncertainty has forced several countries to rethink their defence spending, though it's true these expenses won't necessarily improve wellbeing in the general population. NATO member countries may even upgrade their target from its current 2% of GDP. If it were raised to 3% or higher, the medium-term economic impacts could be significant for many countries.

Climate Change Can't Be Ignored, Either

The energy transition and climate change adaptation will also support domestic demand. It's true that the White House no longer appears interested in reaching decarbonization goals in the short term, but action will be even more urgently needed in a few years. Average global temperatures are already nearly 1.5 °C above pre-industrial levels, and experts have warned that exceeding 2° C, the maximum limit in the Paris Agreement, would be dangerous.

A slowdown in green tech investment is quite possible in the United States, but America is not the world. Looking elsewhere in the world, we can see that China has emerged as a leader on this front, and Europe is continuing to accelerate its investments. It remains to be seen where Canada will stand. Some major projects appear to be on hold—but not all. For example, Hydro-Québec still plans to invest nearly $200 billion by 2035 to increase its clean energy production capacity.

Do We Have What It Takes to Reach Our Goals?

There's nothing wrong with being ambitious. But long-term economic growth won't materialize without several key factors: available resources, an adequate supply of workers, technological advances and the capital required to meet financing needs. The world may not have the capacity to do everything. Economic limits can't necessarily be worked around. Choices will have to be made, and some projects will be postponed.

We believe that economic growth in Canada and the United States won't manage to stay above 2% without eventually triggering overheating. At that point, we could see upward pressure on certain prices and wages, as well as on interest rates. For our medium-term forecasts, we are assuming inflation will remain close to target, but for that to be guaranteed, we expect central banks will need to raise interest rates slightly, following the cuts projected for this year.

Table 6
Major Medium-Term Economic and Financial Indicators

	Annual average							Averages	
% (unless otherwise indicated)	2023	2024	2025f	2026f	2027f	2028f	2029f	2020–2024	2025–2029f
United States									
Real GDP (% change)	2.9	2.8	1.4	1.4	1.7	1.8	1.9	2.4	1.6
Total inflation rate (% change)	4.1	3.0	2.8	2.6	2.3	2.1	2.0	4.2	2.4
Unemployment rate	3.6	4.0	4.4	4.9	4.7	4.5	4.2	4.9	4.5
S&P 500 index (% change)[1]	24.2	23.3	3.7	14.8	5.7	6.1	5.1	3.0	7.1
Federal funds rate	5.20	5.31	4.25	3.44	3.25	3.25	3.25	3.25	3.49
Prime rate	8.20	8.31	7.25	6.44	6.25	6.25	6.25	6.25	6.49
Treasury bills – 3-month	5.28	5.18	4.06	3.30	3.13	3.10	3.10	3.10	3.34
Federal bonds – 10-year	3.96	4.21	4.24	4.05	3.91	3.90	3.90	3.90	4.00
– 30-year	4.09	4.41	4.69	4.44	4.24	4.20	4.20	4.20	4.35
WTI oil (US$/barrel)	78	77	69	65	65	68	68	68	67
Gold (US$/ounce)	1,943	2,387	3,209	3,254	3,215	3,178	3,178	3,178	3,207
Canada									
Real GDP (% change)	1.5	1.6	1.4	1.4	2.0	1.9	1.8	2.6	1.7
Total inflation rate (% change)	3.9	2.4	2.2	2.1	2.0	2.0	2.0	3.4	2.0
Employment (% change)	3.0	1.9	1.2	0.2	1.4	1.3	1.1	1.7	1.0
Employment (thousands)	593	382	251	35	290	291	209	332	215
Unemployment rate	5.4	6.4	7.1	7.2	6.6	6.2	6.2	6.8	6.7
Housing starts (thousands of units)	242	245	242	234	227	243	263	248	242
S&P/TSX index (% change)[1]	8.1	18.0	7.6	10.9	5.0	5.0	4.0	3.0	6.5
Exchange rate (US$/C$)	0.75	0.70	0.74	0.77	0.77	0.78	0.80	0.75	0.77
Overnight rate	4.74	4.59	2.44	2.06	2.44	2.75	2.75	2.75	2.49
Prime rate	6.94	6.75	4.64	4.26	4.64	4.95	4.95	4.95	4.69
Mortgage rate – 1-year	7.14	7.64	5.40	4.60	4.70	4.80	4.85	4.85	4.87
– 5-year	6.68	6.73	6.00	5.80	5.50	5.60	5.70	5.70	5.72
Treasury bills – 3-month	4.74	4.37	2.36	2.08	2.55	2.75	2.75	2.75	2.50
Federal bonds – 2-year	4.27	3.67	2.33	2.19	2.63	2.80	2.85	2.85	2.56
– 5-year	3.57	3.30	2.57	2.48	2.73	2.85	2.85	2.85	2.69
– 10-year	3.36	3.34	3.03	2.78	2.91	2.95	2.95	2.95	2.92
– 30-year	3.28	3.33	3.32	3.08	3.19	3.20	3.20	3.20	3.20
Yield spreads (Canada–United States)									
Treasury bills – 3-month	-0.54	-0.81	-1.70	-1.22	-0.58	-0.35	-0.35	-0.35	-0.84
Federal bonds – 10-year	-0.60	-0.87	-1.21	-1.27	-1.00	-0.95	-0.95	-0.95	-1.08
– 30-year	-0.81	-1.08	-1.37	-1.36	-1.05	-1.00	-1.00	-1.00	-1.16
Quebec									
Real GDP (% change)	0.6	1.4	1.1	1.2	1.8	1.7	1.5	1.6	1.5
Total inflation rate (% change)	4.5	2.3	2.2	2.1	2.0	2.0	2.0	3.6	2.1
Employment (% change)	2.9	0.9	1.3	0.1	1.1	0.8	0.5	1.3	0.8
Employment (thousands)	128	39	64	30	49	39	25	53	41
Unemployment rate	4.4	5.3	6.1	6.0	5.3	5.1	5.2	5.8	5.5
Retail sales (% change)	3.7	2.1	3.5	4.5	4.7	4.0	3.1	6.1	4.0
Housing starts (thousands of units)	39	49	57	57	57	57	58	53	57

f: forecast; WTI: West Texas Intermediate; [1] Changes are based on end-of-period data.
Datastream, Statistics Canada, Canada Mortgage and Housing Corporation, Institut de la statistique du Québec and Desjardins Economic Studies